

MULTIMEDIA



UNIVERSITY

STUDENT ID NO

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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 3, 2017/2018

BFE2074 – FINANCIAL ECONOMICS

(All Sections/Groups)

1 JUNE 2018
3.00 p.m. - 5.00 p.m.
(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This Question paper consists of **THREE** pages with **FOUR** questions only.
2. Attempt **ALL FOUR** questions. The distribution of the marks for each question is given.
3. Please write all your answer in the Answer Booklet provided.

Answer all questions in the answer booklet provided.

Question One (25 marks)

- (a) How are interest yields, financial instrument prices, and interest-rate risk interrelated? (6 marks)
- (b) Suppose you are interested in an adventure tour to Siberia next year. However, you are worried about the price of such a trip, which in the past has ranged from \$4,500 to \$5,500. The current price of such a trip is \$5,000.
- (i) How could you enter into a forward contract with a tour operator to eliminate your price risk? (3 marks)
- (ii) Why would the operator be interested in accepting your forward contract? (4 marks)
- (c) Explain, by giving an example, on why interest arbitrage is important in determining capital flows between countries. (12 marks)

Question Two (25 marks)

- (a) Describe what the term "J-curve" means. Why is this concept important? (10 marks)
- (b) If a visitor to Malaysia from the Australia can buy more goods in Malaysia than he can buy in Australia when he converts Australian dollars to Malaysian ringgit, is the Australian dollar undervalued or overvalued? Explain. (7 marks)
- (c) Suppose the Malaysian economy expands at a faster pace than that of its trading partners. Using the absorption approach, explain why the Ringgit Malaysia (RM) might depreciate relative to the currencies of its trading partners. (8 marks)

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Question Three (25 marks)

(a) Explain the following schedules:

- (i) IS Schedule (3 marks)
- (ii) LM Schedule (3 marks)
- (iii) BP Schedule (3 marks)

(b) Illustrate **TWO** factors each that shift the

- (i) IS schedule rightward. (4 marks)
- (ii) LM schedule downward and to the right. (4 marks)

(c) Using the IS-LM-BP model, draw a diagram to show that the nation's economy is facing a balance-of-payments surplus. (8 marks)

Question Four (25 marks)**Passage 1****Argentina inflation reached 24.8% in 2017, well above central bank's target**

Friday, January 12th 2018 - 10:50 UTC

Consumer prices in Argentina rose 24.8% in 2017 after a sharp 3.1% increase in December, government data showed on Thursday, well above the central bank's target range for annual inflation of 12-17%. The monthly reading, which was above median expectations in December of 2.5%.

The government in late December relaxed its 2018 inflation target to 15%, up from the central bank's previous 8-12% goal. The central bank cut interest rates earlier this week after relaxing the inflation target.

Hikes in prices for utilities, gasoline and transportation as the government cuts subsidies to reduce its wide fiscal deficit have contributed to inflation's persistence. In December, regulated prices surged 9.1% compared with the prior month, while core inflation - which excludes regulated and seasonal prices - was 1.7%.

In greater Buenos Aires, which had been used as a proxy for the country's inflation before the Indec statistics agency launched a nationwide index last year, consumer prices rose 3.4% in December, the biggest increase this year.

Source: Argentina inflation reached 24.8% in 2017, well above central bank's target (2018, Jan 12), *MecroPress*. Retrieved from <http://en.mercopress.com/2018/01/12/argentina-inflation-reached-24.8-in-2017-well-above-central-bank-s-target>

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Based on **Passage 1**, answer the following questions.

- (a) What is the major problem faced by Argentina? (2 marks)
- (b) Explain **TWO (2)** types of inflation costs and their causes. (4 marks)
- (c) Explain the concept of monetary policy. **Who** conducts it and **how** do they work its way through the economy? (5 marks)
- (d)
 - (i) What types of monetary policy should the central bank of Argentina implement to fix the problem stated in part (a)? (2 marks)
 - (ii) Assuming Argentina is an economy with relatively high capital mobility and adopting a floating exchange rate system, trace through the likely effects of this policy action within the IS-LM-BP framework. (12 marks)

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